

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 TRSE-00 COME-00 EB-11 FRB-02 L-03 H-03

SS-20 SP-03 NSC-07 PA-04 PRS-01 USIA-15 CIAE-00

INR-10 NSAE-00 RSC-01 FTC-01 AID-20 IGA-02 CIEP-02

CEA-02 DRC-01 OMB-01 /130 W
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R 291613Z MAY 74

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 3500

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

UNCLAS SECTION 1 OF 2 BRASILIA 3773

PASS TREASURY AND COMMERCE

E.O.11652: N/A

TAGS: EFIN, BR

SUBJECT: MINISTERIAL ORDINANCE INTERPRETS CONTROVERSIAL
INCOME TAX PROVISION

FOLLOWING REPORT PREPARED BY CONGENRIO:

1. SUMMARY: NEW MINISTRY OF FINANCE ORDINANCE
INTERPRETS LAW WHICH HAS LONG THREATENED TO CAUSE
AN INCOME TAX CONTROVERSY BETWEEN GOB AND PRIVATE
FOREIGN ENTERPRISES, ESPECIALLY US SUBSIDIARIES. THE
LAW AND ITS IMPLEMENTING REGULATIONS HAD BEEN EXPLAINED AS
AN EFFORT TO TAX PROFITS MADE BY THE FOREIGN FIRMS SELLING
IN BRAZIL THROUGH AGENTS OR REPRESENTATIVES WHO
HAVE FULL POWERS TO BIND THE SELLER. SUBSEQUENT
RULINGS SEEMED TO EXTEND APPLICATION OF LAW TO SALES
IN WHICH LOCAL PERMANENT ESTABLISHMENTS ARE INVOLVED
EVEN THOUGH THEY DO NOT HAVE CONTRACTUAL AUTHORITY
TO BIND THE SELLER. DOUBLE TAXATION TREATIES
BETWEEN BRAZIL AND SEVERAL COUNTRIES SUBSEQUENTLY
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DEFINED CONCEPT OF PERMANENT ESTABLISHMENT IN

EFFORT TO EXEMPT FROM LAW BRAZILIAN SUBSIDIARIES
OF COMPANIES FROM THESE COUNTRIES. IF THIS ORDINANCE
STANDS, HOWEVER, IT ELIMINATES ONE IRRITANT THAT MIGHT HAVE
BEEN COVERED BY A LIMITED US-BRAZIL DOUBLE
TAXATION TREATY. END OF SUMMARY

2. MINISTRY OF FINANCE ORDINANCE NUMBER 228 OF MAY 8,
1974 (PUBLISHED IN DIARIO OFICIAL OF MAY 13, 1974) GAVE
A NEW INTERPRETATION TO ARTICLE 76 OF LAW 3,470 DATED
NOVEMBER 28, 1958. ARTICLE 76 STATES
QUOTE LEGAL PROVISIONS WHICH REGULATE THE
TAXATION OF PROFITS MADE IN BRAZIL BY BRANCHES, AGENTS
OR REPRESENTATIVE OFFICES OF FOREIGN COMPANIES AUTHOR-
IZED TO OPERATE IN BRAZIL, ALSO EMBRACE INCOME EARNED
BY CONSTITUENTS DOMICILED ABROAD IN TRANSACTIONS
EFFECTED BY THEIR AGENTS OR REPRESENTATIVES IN BRAZIL.
PARAGRAPH 1 - FOR THE PURPOSE OF THIS ARTICLE, THE
AGENT OR REPRESENTATIVE OF THE CONSTITUENT DOMICILED
ABROAD WILL MAKE ENTRIES IN ITS COMMERCIAL BOOKS SO
AS TO SHOW, IN ADDITION TO ITS OWN REVENUE, THE REAL
PROFITS MADE EACH YEAR IN TRANSACTIONS FOR THIRD PARTY
ACCOUNTS.
PARAGRAPH 2 - WHEN PROFITS RESULTING FROM THE TRANSACT-
IONS DEALT WITH IN THIS ARTICLE ARE NOT REGULARLY DETERM-
INED, AN ARBITRARY PROFIT WILL BE ESTABLISHED FOR TAXATION
PURPOSES, PURSUANT TO LEGISLATION IN FORCE.
PARAGRAPH 3 - IN CASES WHERE COMPANIES SELL IN BRAZIL
THROUGH AGENTS OR REPRESENTATIVES, TAX WILL APPLY ON A
PRESUMED PROFIT OF TWENTY PERCENT OF THE VALUE INVOICED
BY THE FOREIGN SELLER UNQUOTE.

3. APPARENTLY, PARAGRAPH 3 OF ARTICLE 76 AND SUBS-
EQUENT REGULATIONS (DECREE NO. 47.373 OF DECEMBER 7,
1959) WERE AIMED AT TAXING PROFITS MADE BY FOREIGN FIRMS
SELLING IN BRAZIL THROUGH AGENTS OR REPRESENTATIVES HAVING
FULL POWERS TO BIND THE SELLER. NEVERTHELESS, A SERIES
OF ADMINISTRATIVE RULINGS, SUPPORTED IN ONE CASE BY
FEDERAL COURT OF APPEALS, GAVE IMPRESSION THAT MANUFACT-
URING SUBSIDIARIES OF FOREIGN COMPANIES SELLING TO
BRAZIL COULD BE LIABLE TO INCOME TAX ON SALES BY THEIR
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PARENT FIRMS. IN FACT, IMPRESSION WAS GIVEN THAT TAX
MIGHT BE APPLIED EVEN THOUGH BRAZILIAN SUBSIDIARY
PLAYED LITTLE OR NO ROLE IN MAKING SALES AND DID
NOT HAVE POWERS TO BIND PARENT FIRM. THESE RULINGS
DISTURBED MANY BUSINESSMEN WHO FEARED GOB COULD AT ANY
TIME PRESENT THEM WITH LARGE BILL FOR BACK TAXES DUE ON
PAST EXPORTS TO BRAZIL BY THEIR PARENT COMPANIES.

4. REGULATIONS IMPLEMENTING ARTICLE 76 (ARTICLE 34 OF DECREE 47373 OF DECEMBER 7, 1959) STATED QUOTE FOR THE PURPOSE OF PARAGRAPH 3 OF ARTICLE 76, THE SALE WILL BE CONSIDERED AS MADE IN BRAZIL WHEN IT IS CONCLUDED IN ACCORDANCE WITH THE TERMS OF COMMERCIAL LAW BETWEEN THE BUYER AND THE AGENT OR REPRESENTATIVE IN BRAZIL UNQUOTE. IT WAS UNDERSTOOD THAT THE LAW INTENDED TO ESTABLISH THAT SALES MADE IN BRAZIL BY COMPANIES WHICH HAVE THEIR PERMANENT ESTABLISHMENTS IN BRAZIL SHOULD, FOR THIS PURPOSE, BE CONSIDERED AS TRANSACTIONS ORIGINATING AND BEING CONSUMMATED IN BRAZIL AND THEREFORE PROFIT THEREON SHOULD BE TAXABLE IN BRAZIL. A DEFINITION OF QUOTE PERMANENT ESTABLISHMENT UNQUOTE WAS, THEREFORE, INCORPORATED INTO DOUBLE TAXATION TREATIES CONCLUDED SUBSEQUENTLY BETWEEN BRAZIL AND THIRD COUNTRIES. SUBSIDIARIES OF US FIRMS WERE THUS PLACED AT A DISADVANTAGE VIS A VIS SUBSIDIARIES OF FIRMS FROM COUNTRIES THAT NEGOTIATED DOUBLE TAXATION TREATIES WITH BRAZIL. NEVERTHELESS, ONE OF THE LATEST COURT RULINGS ON ARTICLE 76 HAD BROUGHT INTO QUESTION WHETHER AN AGREEMENT DEFINING QUOTE PERMANENT ESTABLISHMENT UNQUOTE WOULD PROVIDE PROTECTION SOUGHT BY US BUSINESS COMMUNITY.

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R 291613Z MAY 74

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UNCLAS SECTION 2 OF 2 BRASILIA 3773

PASS TREASURY AND COMMERCE

IN DENYING US FIRMS EXEMPTION FROM ARTICLE 76, FEDERAL COURT OF APPEALS IN BRASILIA HELD THE FOLLOWING IN A 1971 SENTENCE QUOTE THERE IS NO BASIS ON WHICH TO HOLD THAT A FOREIGN INDIVIDUAL OR CORPORATION, SIMPLY BECAUSE IT IS FOREIGN, IS FREE OR EXEMPT FROM PAYING INCOME TAX IN BRAZIL, SINCE THE PRINCIPLE OF TERRITORIALITY OF BRAZILIAN TAX LAWS DOES NOT PERMIT SUCH INTERPRETATION. IF BRAZILIAN TAX AUTHORITIES DO NOT COLLECT INCOME TAX FROM INDIVIDUALS AND CORPORATIONS RESIDING ABROAD, IT IS NOT BECAUSE THEY ARE NOT SUBJECT TO BRAZILIAN TAX LEGISLATION, BUT ONLY BECAUSE OF IMPLICATIONS OF AN INTERNATIONAL NATURE UNQUOTE.

5. MINISTRY OF FINANCE ORDINANCE 228 OF MAY 8, 1974, IN EFFECT REVERSES PREVIOUS GOB POSITION AND CONFLICTS WITH PREVIOUS DECISION BY PROVIDING FOLLOWING SUMMARIZED REINTERPRETATION TO ARTICLE 76:
(A) PROVISIONS OF THE FIRST AND SECOND PARAGRAPH OF ARTICLE 76 APPLY ONLY TO INCOME EARNED BY CONSTITUENTS RESIDENT OR DOMICILED ABROAD WHO REMIT GOODS TO BRAZIL
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CONSIGNED TO COMMISSIONERS, MANDATORIES, AGENTS OR REPRESENTATIVES, SO THAT THEY MAY SELL THEM IN BRAZIL BY ORDER AND ON ACCOUNT OF THE CONSTITUENTS.
(B) IN CASE OF SALES BILLED DIRECTLY BY THE SELLER RESIDENT OR DOMICILED ABROAD TO THE BUYER IN BRAZIL, PARAGRAPH THREE OF ARTICLE 76 WILL APPLY ONLY IN CASE OF SALES MADE IN BRAZIL BY RESIDENT OR DOMICILED AGENT OR REPRESENTATIVE WHO HAS POWERS TO BIND THE SELLER WITH THE BUYER IN BRAZIL, OR THROUGH THE SELLER'S BRANCH, BRANCH OFFICE OR AGENCY IN BRAZIL. THE TAX WILL NOT REPEAT NOT APPLY IN CASE OF SALES IN WHICH ACTION OF THE AGENT OR REPRESENTATIVE HAS BEEN LIMITED TO BUSINESS INTERMEDIATION, OBTAINING OR FORWARDING REQUESTS OR ORDERS, EVEN IF SUCH SERVICES ARE REMUNERATED, PROVIDED THE AGENT OR REPRESENTATIVE DOES NOT HAVE POWERS TO BIND THE SELLER. THE EXCLUSIVE FACT THAT THE SELLER OPERATES IN THE COUNTRY DOES NOT IMPLY THE ATRIBUTION OF BINDING POWERS TO THIS AGENT OR REPRESENTATIVE. ALSO, THE FACT THAT THE LEGAL REPRESENTATIVE OF THE SELLER OR HIS ATTORNEY EVENTUALLY SIGNS A CONTRACT IN BRAZIL ON BEHALF OF THE SELLER IS NOT SUFFICIENT GROUND FOR APPLICATION OF ARTICLE 76. A FREE ENGLISH TRANSLATION OF ORDINANCE 228 WILL FOLLOW BY AIRGRAM.

COMMENTS: 1. RESIDENT FOREIGN BUSINESSMEN RECEIVED FAVORABLY THE NEW INTERPRETATION OF ARTICLE 76. IT HAS

ATTENUATED THIER CONCERN THAT PREVIOUS INTERPRETATIONS OF THIS LEGAL PROVISION MIGHT PRODUCE ADVERSE EFFECTS ON FOREIGN TRADE AND INVESTMENT.

2. MINISTRY'S ORDINANCE WILL GUIDE FUTURE ACTION OF FISCAL AUTHORITIES. NEVERTHELESS, AS ANY OTHER ADMINISTRATIVE RULINGS AND ESPECIALLY THOSE INTERPRETING LEGAL PROVISIONS, IT CAN BE CONTESTED IN THE COURTS. CURRENTLY, THERE ARE SOME QUOTE ARTICLE 76 UNQUOTE CASES PENDING DECISION BY THE JUDICIARY. ATTITUDE THAT COURTS WILL NOW ADOPT, GIVEN THE ISSUANCE OF THE MINISTER'S ORDINANCE, REMAINS TO BE SEEN. IF COURT DECISIONS REJECT THE NEW ADMINISTRATIVE RULING, THE MATTER MAY GO TO SUPREME COURT FOR FINAL DECISION UNLESS ARTICLE 76 IS AMENDED BY ANOTHER LAW.

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3. THE SITUATION OF SUBSIDIARIES OF US COMPANIES WITH RESPECT TO QUOTE ARTICLE 76 UNQUOTE PROBLEM HAS NO DOUBT IMPROVED. NEVERTHELESS, THEY STILL DO NOT ENJOY THE SAME SECURITY AS SUBSIDIARIES WHOSE PARENT FIRMS ARE LOCATED IN COUNTRIES THAT HAVE DOUBLE TAXATION TREATIES WITH BRAZIL DEFINING CONCEPT OF QUOTE PERMANENT ESTABLISHMENT UNQUOTE. SUCH TREATIES, HAVING BEEN RATIFIED BY BRAZILIAN CONGRESS, HAVE THE FORCE OF LAW WHILE THE MINISTER'S ORDINANCE IS AN ADMINISTRATIVE RULING ONLY. IF THIS ORDINANCE STANDS, HOWEVER, IT ELIMINATES ONE IRRITANT THAT MIGHT HAVE BEEN COVERED BY A LIMITED US-BRAZIL DOUBLE TAXATION TREATY.

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